

## § 10.304

## 19 CFR Ch. I (4–1–03 Edition)

than 50 percent of the value of the goods when exported to the United States;

(ii) The assembled goods are not subsequently processed or further assembled in a third country; and

(iii) The goods satisfy the requirement in § 10.306.

(b) *Originating materials.* For purposes of this section and § 10.305, the term “materials” means goods, other than those included as part of the direct cost of processing or assembling, used or consumed in the production of other goods, and the term “originating” when used with reference to such materials means that the materials satisfy one of the criteria for originating goods set forth in paragraph (a) of this section.

(c) *Change in classification.* For purposes of paragraph (a) of this section, the expression “change in classification” means a change of classification within the Harmonized Commodity Description and Coding System (Harmonized System) as published and amended from time to time by the Customs Cooperation Council.

(d) *Articles of feather.* The goods are eligible to be treated as originating in Canada pursuant to General Note 3(c)(vii)(R)(12)(ee), HTSUS.

[T.D. 92–8, 57 FR 2453, Jan. 22, 1992]

### § 10.304 Exclusions.

(a) *Changes based on simple processing.* No goods shall be considered originating for purposes of eligibility under the Agreement if they have merely undergone simple packaging or simple combining operations, or have undergone mere dilution with water or with another substance that does not materially alter the characteristics of the goods.

(b) *Other excluded processing.* No goods shall be considered to be originating merely by virtue of having undergone any process or work in which the facts clearly justify the presumption that the sole object was to circumvent the provisions of Chapter 3 of the Agreement.

### § 10.305 Value content requirement.

(a) *Direct cost of processing or assembling.*

(1) *Definition.* For purposes of applying a specific rule of origin under the

Agreement which requires a value content determination, the terms “direct cost of processing” and “direct cost of assembling” mean the costs directly incurred in, or that can be reasonably allocated to, the production of goods, including:

(i) The cost of all labor, including benefits and on-the-job training, labor provided in connection with supervision, quality control, shipping, receiving, storage, packaging, management at the location of the process or assembly, and other like labor, whether provided by employees or independent contractors;

(ii) The cost of inspecting and testing the goods;

(iii) The cost of energy, fuel, dies, molds, tooling, and the depreciation and maintenance of machinery and equipment, without regard to whether they originate within the territory of the United States or Canada;

(iv) Development, design, and engineering costs;

(v) Rent, mortgage interest, depreciation on buildings, property insurance premiums, maintenance, taxes and the cost of utilities for real property used in the production of the goods; and

(vi) Royalty, licensing, or other like payments for the right to the goods.

(2) *Exclusions from direct costs of processing or assembling.* Excluded from the direct costs of processing or assembling are:

(i) Costs relating to the general expense of doing business, such as the cost of providing executive, financial, sales, advertising, marketing, accounting and legal services, and insurance;

(ii) Brokerage charges relating to the importation and exportation of goods;

(iii) Costs for telephone, mail, and other means of communication;

(iv) Packing costs for exporting the goods;

(v) Royalty payments related to a licensing agreement to distribute or sell the goods;

(vi) Rent, mortgage interest, depreciation on buildings, property insurance premiums, maintenance, taxes, and the cost of utilities for real property used by personnel charged with administrative functions; and

(vii) Profit on the goods.

(3) *Interpretation*—(i) *Indirect materials*. Under the definition of “materials” set forth in §10.303(b), certain types of materials are treated as direct costs of processing or assembling under paragraph (a) of this section. This applies principally to materials used or consumed indirectly in the production of exported goods, where no portion of those materials is physically incorporated in the exported goods. In addition to the items specified in paragraph (a)(1)(iii) of this section, such materials include items such as gloves and safety glasses worn by production workers, tape used in painting processes, and tools, materials and spare parts used in the repair and maintenance of machinery and equipment used in the production of the exported goods. Such materials are to be distinguished from waste and spoilage specified in paragraph (b)(1)(ii)(C) of this section, which relate to materials that are physically incorporated in the exported goods.

(ii) *Directly incurred*. In order for costs incurred by a production facility to be treated as direct costs of processing or assembling, those costs must be directly incurred in the production of the exported goods and not merely associated with the production facility as peripheral costs necessary to operate the facility. In addition to the exclusions set forth in paragraph (a)(2) of this section, such peripheral costs include labor costs for nurses tending to employees, for accounting personnel involved in physical inventory taking, for personnel responsible for purchasing or requisitioning materials to be used or consumed in the production process, and for second level supervisors and above who are not directly involved in the production process.

(iii) *Labor costs*. Under paragraph (a)(1)(i) of this section, labor costs includable as direct costs of processing or assembling are limited to labor provided by the producer’s employees or by independent contractors. Thus, for example, where processing operations are performed on components in the United States and those components are sold to a manufacturer in Canada where they are incorporated in goods exported to the United States, the cost of those processing operations in the

United States cannot be separately counted as a direct cost of processing attributable to the finished goods exported to the United States.

(iv) *Interest expense*. *Bona fide* interest payments on debt of any form, secured or unsecured, undertaken on arm’s length terms in the ordinary course of business to finance the acquisition of fixed assets such as real property, a plant, and/or equipment used in the production of goods in the territory of Canada or the U.S. are includable in the direct cost of processing or direct cost of assembling. Interest will be treated as a direct cost of processing or assembling, but only that portion of the interest which is related to a fixed asset directly used in the production of the goods exported; thus, where a entire production facility is covered by a mortgage and incorporates both production and administrative or other general expense space, an appropriate allocation must be made in order to ensure that only that portion of the interest allocated to the production area is counted toward the value-content requirement. Interest expenses attributable to general and administrative costs or expenses, including interest on funds borrowed to meet the payroll of personnel directly involved in the production of goods, are not considered direct costs of processing or assembly.

(b) *Value of originating materials*—(1) *Definition*. The term “value of materials originating in the United States or Canada or both” means the aggregate of:

(i) The price paid by the producer of exported goods for materials originating in either the United States or Canada, or both, or for materials imported from a third country used or consumed in the production of such originating materials; and

(ii) When not included in that price, the following costs related thereto:

(A) Freight, insurance, packing and all other costs incurred in transporting any of the materials referred to in paragraph (b)(1)(i) of this section to the location of the producer;

(B) Duties, taxes and brokerage fees on such materials paid in the United States, or Canada, or both;

(C) The cost of waste or spoilage resulting from the use or consumption of

such materials, less the value of renewable scrap or by-product; and

(D) The value of goods and services relating to such materials determined in accordance with subparagraph 1(b) of Article 8 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade.

(2) *Directly attributable.* Whenever a value-content determination is required by the rules of the Agreement and whenever originating materials and materials obtained or produced in a third country are used or consumed together in the production of goods in the United States or Canada, the value of originating materials may be treated as such only to the extent that the value is directly attributable to the goods under consideration.

(3) *Interpretation.* (i) *Price paid.* As provided in paragraph (b)(1) of this section, the “price paid” for materials by the producer of exported goods forms the basis for determining the value of such materials when incorporated in the exported goods. The actual price paid for such materials will determine the value of those materials for purposes of the value-content requirement, even though a relationship between the producer and the seller of the materials may have influenced the price, except where the price did not include items specified in paragraph (b)(1)(ii) of this section that relate to the materials. The following examples will illustrate these principles. Notwithstanding these examples, the totality of the facts must be examined in each case to determine whether § 10.304(b) is applicable.

*Example 1.* Non-originating materials are sold by Company X (a foreign corporation located outside the United States or Canada) to Company Y (a Canadian corporation) for \$100; Company X also sold identical materials to Company Z (a U.S. corporation) for \$200 which was the price Company Z had paid to Company X for similar materials prior to implementation of the Agreement; and those non-originating materials sold by Company X to Company Y are then incorporated by Company Y into goods exported to the United States. In this case the \$100 price paid by Company Y to Company X constitutes the value of those materials for purposes of the value-content requirement.

*Example 2.* Company X purchased materials for \$100, added a four percent mark-up to the price paid to defray purchasing expenses, and

then sold the marked-up materials to Company Y (a Canadian corporation) which incorporated the materials in goods exported to the United States. In this case the \$104 price paid by Company Y to Company X constitutes the value of the materials for purposes of the value-content requirement.

*Example 3.* Company X (a foreign corporation located outside the United States) sold non-originating materials to Company Y (a U.S. corporation) for \$200, and Company Y then sold those materials for \$100 to Company Z (a Canadian corporation) which incorporated the materials in goods which were imported into the United States by Company P (the U.S. parent company of Company Y). In this case, in accordance with paragraph (b)(1)(ii)(D) of this section, \$100 would be added to the price paid by Company Z for purposes of the value-content requirement because the materials were sold at a reduced cost within the meaning of subparagraph 1(b) of Article 8 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade.

(ii) *Originating materials for which no price paid.* In cases involving a vertically integrated producer (that is, an entity which produces goods for export from materials which that producer has also made) a “price paid” for such originating materials normally does not exist. Even in the absence of a “price paid”, such a vertically integrated producer may still claim the materials as originating materials for purposes of qualifying the finished goods exported to the United States as goods originating in Canada. However, under paragraph (b)(1)(i) of this section the value of those materials for purposes of applying the value-content requirement is limited to the price paid for those materials imported from the third country plus any costs added thereto under paragraph (b)(1)(ii) of this section. The following examples will illustrate these principles.

*Example 1.* If an automobile producer in the United States or Canada fabricates body panels wholly from third country steel coil, those body panels can qualify as originating materials without having to satisfy a value-content requirement because steel coil is classified in chapter 72 of the Harmonized System and body panels are classified in chapter 87 and the change in classification rules in chapter 87 do not incorporate a value-content requirement in this context. Thus, the producer can claim the body panels fabricated from the third country steel as originating materials for purposes of the value-content requirement applicable to the

finished automobile which will be exported to the United States. The value of those originating materials is the price paid for the steel coil imported from the third country and used or consumed in the production of the body panels.

*Example 2.* An automobile exporter in Canada purchases and imports body panels fabricated in a third country in order to join them with vertically (locally) fabricated body panels to form an automobile body. If the body qualifies as an originating material, the exporter has two options. Under the first option, the exporter can claim the body as originating material, in which case the value of originating material is the price paid for the foreign body panels. Under the second option, the exporter may elect not to claim the body as originating material; but, rather, the exporter may claim as originating material any domestic steel coil used in producing the vertically (locally) fabricated body panels, in which case the value of originating material is the price paid for the domestic steel coil.

(c) *Value of goods when exported.* The term “value of the goods when exported to the United States” means the aggregate of:

(1) The price paid by the producer for all materials, whether or not the materials originate in the United States, or Canada, or both, and, when not included in the price paid for the materials, the following costs related thereto:

(i) Freight, insurance, packing, and all other costs incurred in transporting all materials to the location of the producer;

(ii) Duties, taxes, and brokerage fees on all materials paid in the United States, or Canada, or both;

(iii) The cost of waste or spoilage resulting from the use or consumption of such materials, less the value of renewable scrap or by-product; and

(iv) The value of goods and services relating to all materials determined in accordance with subparagraph 1(b) of Article 8 of the Agreement on Implementation of Article VII of the General Agreement on Tariffs Trade; and

(2) The direct cost of processing or the direct cost of assembling the goods.

[T.D. 92-8, 57 FR 2453, Jan. 22, 1992; 57 FR 4793, Feb. 7, 1992, as amended by T.D. 92-98, 57 FR 46504, Oct. 9, 1992]

#### § 10.306 Direct shipment to the United States.

Goods shall be considered as directly shipped to the United States from Canada for the purpose of eligibility for preferences under the Agreement only under the following circumstances:

(a) *Through shipment.* The goods have been shipped directly from Canada to the United States without passage through the territory of any third country; or

(b) *Shipment through a third country.* The goods were shipped through the territory of a third country but:

(1) The goods did not enter the commerce of any third country;

(2) The goods did not undergo any operation other than unloading, reloading, or any operation necessary to transport them to the United States or to preserve them in good condition; and

(3) All shipping and export documents show the United States as the final destination.

#### § 10.307 Documentation.

(a) *Claims for a preference.* A preference in accordance with the Agreement may be claimed by including on the entry summary, or equivalent documentation, the symbol “CA” as a prefix to the subheading of the HTSUS under which each eligible good is classified.

(b) *Failure to claim a preference.* Failure to make a timely claim for a preference under the Agreement will result in liquidation at the rate which would otherwise be applicable.

(c) *Documentation showing origin.* A claim for a preference under the Agreement shall be based on the Exporter's Certificate of Origin, properly completed and signed by the person who exports or knowingly causes the goods to be exported from Canada. The Exporter's Certificate of Origin must be available at the time the preference is claimed and shall be presented to the port director upon request.

(d) *Exporter's Certificate of Origin—(1) General.* The Exporter's Certificate of Origin shall be prepared on Customs Form 353. In lieu of the Customs Form 353, the exporter may use an approved